1967

Proposed APB opinion : Accounting for income taxes;Accounting for income taxes; Exposure draft (American Institute of Certified Public Accountants), 1967, Sept. 14

American Institute of Certified Public Accountants. Accounting Principles Board

EXPOSURE DRAFT

PROPOSED APB OPINION: ACCOUNTING FOR INCOME TAXES

SEPTEMBER 14, 1967

Issued for comment from persons interested in Financial Reporting by the

ACCOUNTING PRINCIPLES BOARD

OF THE

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

CONTENTS

INTRODUCTION

1. This Opinion sets forth the Board's conclusions concerning some aspects of accounting for income taxes. These conclusions include significant modifications of views previously expressed by the committee on accounting procedure and by the Board. Accordingly, this Opinion supersedes the following Accounting Research Bulletins (ARBs) and Opinions of the Accounting Principles Board (APBs):

a. ARB No. 43, Chapter 10, Section B, *Taxes: Income Taxes.*

b. Letter of April 15, 1959, addressed to the members of the Institute by the Committee on Accounting Procedure interpreting ARB 44 (Revised).

c. APB Opinion No. 2, *Accounting for the "Investment Credit,"* except for Addendum, *Accounting Principles for Regulated Industries,* which remains in effect.

d. APB Opinion No. 4 (Amending No. 2), *Accounting for the "Investment Credit."*

e. APB Opinion No. 6, *Status of Accounting Research Bulletins,* (paragraphs 21 and 23).

f. APB Opinion No. 1, *New Depreciation Guidelines and Rules,* (paragraphs 5-7).

g. APB Opinion No. 5, *Reporting of Leases in Financial Statements of Lessee,* (paragraph 21).

2. This Opinion also amends the following ARBs and APBs insofar as they relate to accounting for income taxes:

a. ARB No. 43, Chapter 9, Section C, *Depreciation: Emergency Facilities — Depreciation, Amortization and Income Taxes,* (Paragraphs 11-13).

b. ARB No. 43, Chapter 11, Section B, *Government Contracts: Renegotiation,* (paragraph 8).

c. ARB No. 43, Chapter 15, *Unamortized Discount Issue Cost, and Redemption Premium on Bonds Refunded,* (paragraph 11).

d. ARB No. 44 (Revised), *Declining-balance Depreciation,* (paragraphs 4-7, 10).

e. ARB No. 51, *Consolidated Financial Statements,* (paragraph 17).

3. *Discounting.* The Board's Opinion with respect to "Tax Allocation Accounts — Discounting," as expressed in APB Opinion No. 10, *Omnibus Opinion—1966,* (paragraph 6), continues in effect pending further study of the broader aspects of discounting as it is related to financial accounting in general.

4. Certain aspects of tax allocation, including illustrations of procedures and an extended discussion of alternative approaches to allocation, are presented in Accounting Research Study No. 9, *Interperiod Allocation of Corporate Income Taxes,* by Homer A. Black, published by the American Institute of Certified Public Accountants in 1966.[1] The Board in its deliberations and in preparing this Opinion has considered the Study and the comments received on it. The conclusions expressed in this Opinion vary in some important respects from those reached in the Study.

APPLICABILITY

5. This Opinion applies to financial statements which purport to present financial position and results of operations in conformity with generally accepted accounting principles. It does not apply to certain special areas requiring further study as specifically indicated in paragraphs 37-40 and may not apply in all respects to regulated industries. The Board has deferred consideration of the special problems in accounting for income taxes that arise in the preparation of interim financial statements and financial statements for components of a business enterprise pending further study and the issuance of Opinions on the applicability of generally accepted accounting principles to such statements.

SUMMARY OF PROBLEMS

6. The principal problems in accounting for income taxes arise from the fact that some transactions affect the determination of net income for financial accounting purposes in one reporting period and the computation of taxable income and income taxes payable in a different reporting period. The amount of income taxes determined to be payable for a period does not, therefore, necessarily represent the appropriate income tax expense applicable to transactions recognized for financial accounting purposes in that period.

7. Certain transactions embody timing differences; that is, differences between the periods in which the transactions affect taxable income and the periods in which they enter into the determination of pretax accounting income. A major problem concerns measurement of the tax effects of such transactions and the extent to which such tax effects should be included in income tax expense in the same periods as the transactions affect pretax accounting income.

8. The income tax laws and regulations permit "net operating losses" of one period to be deducted in determining taxable income of another period. This leads to the question of whether the tax effects of operating losses should be recognized for financial accounting purposes in the period of loss or in the periods of reduction of taxable income.

9. The investment credit provisions of the United States Internal Revenue Code provide for income tax credits in the period of acquisition of certain depreciable assets. One problem in accounting for investment credits is whether the credits should affect income tax expense in the period the related property is acquired, or whether they should affect income tax expense in the periods in which the costs of the related property enter into the determination of pretax accounting income through provisions for depreciation or amortization.

[1] Accounting Research Studies are not statements of this Board or of the Institute, but are published for the purpose of stimulating discussion on important accounting issues.

10. Certain items includable in the determination of taxable income receive special treatment for financial accounting purposes, even though the items are reported in the same period in which they are deducted for tax purposes. A question exists, therefore, as to whether the tax effects attributable to extraordinary items, adjustments of prior periods or of the opening balance of retained earnings, and direct entries to other stockholders' equity accounts should be associated with the particular items for financial reporting purposes.[2]

11. There is a need also for the establishment of guidelines for recognition and presentation both in the balance sheet and in the income statement of the tax effects of timing differences, operating losses, investment credits, and similar items.

SUMMARY OF CONCLUSIONS

12. The Board's conclusions concerning some of the problems in accounting for income taxes are summarized as follows:

a. Interperiod tax allocation is an integral part of the determination of income tax expense, and income tax expense should include the tax effects of all revenue and expense items included in the determination of pretax accounting income.

b. Interperiod tax allocation procedures should follow the deferred method,[3] both in the manner in which tax effects are initially recognized and in the manner in which deferred taxes are amortized in future periods.

c. The tax effects of operating loss carry*backs* should be allocated to the loss periods. The tax effects of operating loss carry*forwards*[4] usually should not be recognized until the periods of realization.

d. Allowable investment credits usually should be applied in the determination of income tax expense in those periods in which the costs of the related property giving rise to the investment credits enter into the determination of pretax accounting income through provisions for depreciation or amortization.

e. Tax allocation within a period should be applied in order to obtain fair presentation of the various components of results of operations.

f. Financial statement presentations of income tax expense and related deferred taxes should indicate clearly (1) the composition of income tax expense as between amounts currently payable and amounts representing tax effects allocable to the period, and (2) the classification of deferred charges and deferred credits into a net current amount and a net noncurrent amount.

DEFINITIONS AND CONCEPTS

13. Terminology relating to the accounting for income taxes is varied; some terms have been used with different meanings. Definitions of certain terms used in this Opinion are therefore necessary.

a. *Income taxes.* Taxes based on income determined under provisions of the United States Internal Revenue Code and foreign, state and municipal taxes (including franchise taxes) based on income.

b. *Income tax expense.* The amount of income taxes (whether or not currently payable) allocable to a period in the determination of net income.

c. *Pretax accounting income.* Net income or net loss for a period, exclusive of related income tax expense.

d. *Taxable income.* The excess of revenues over deductions or the excess of deductions over revenues to be reported for income tax purposes for a period.[5]

e. *Timing differences.* Difference between the periods in which transactions[6] affect taxable income and the periods in which they enter into the determination of pretax accounting income. Each timing difference originates in one period and reverses or "turns around" in one or more subsequent periods. Some timing differences have the effect of reducing income taxes that would otherwise be payable currently; others have the effect of increasing income taxes that would otherwise be payable currently.

f. *Permanent differences:* Difference between taxable income and pretax accounting income arising from transactions that, under applicable tax laws and regulations, will not be offset by corresponding differences or "turn around" in other periods.

g. *Tax effects.* Differentials in income taxes of a period attributable to (1) items of revenue or expense which enter into the determination of pretax accounting income in one period and into the determination of taxable income in another period, (2) reductions in income taxes arising from investment credits and from deductions or credits that may be carried backward or forward for income tax purposes, and (3) adjustments of prior periods or of the opening balance of retained earnings and direct entries to other stockholders' equity accounts which enter into the determination of taxable income in a period but

[2] See APB Opinion No. 9, *Reporting the Results of Operations.*

[3] See paragraph 19.

[4] The term "loss carry *forwards*" is used in this opinion to mean "loss carryovers" as referred to in the United States Internal Revenue Code.

[5] For the purposes of this definition "deductions" do not include reductions in taxable income arising from net operating loss carry*backs* or carry*forwards.*

[6] The term "transaction" refers to all transactions and other events requiring accounting recognition.

which do not enter into the determination of pretax accounting income of that period. A permanent difference does not result in a "tax effect" as that term is used in this Opinion.

h. *Deferred taxes.* Tax effects which are deferred for allocation to income tax expense of future periods.

i. *Interperiod tax allocation.* The process of apportioning income taxes among periods.

j. *Tax allocation within a period.* The process of apportioning income tax expense applicable to a given period between income before extraordinary items and extraordinary items, and of associating the income tax effects of adjustments of prior periods or the opening balance of retained earnings, and direct entries to other stockholders' equity accounts with such items.

14. Certain general concepts and assumptions are recognized by the Board to be relevant in considering the problems of accounting for income taxes.

a. The operations of an entity subject to income taxes are expected to continue on a going concern basis, in the absence of evidence to the contrary, and income taxes are expected to continue to be assessed in the future.

b. Income taxes are an expense of business enterprises earning income subject to tax. This interpretation of the nature of income taxes is established in accounting literature as well as in business thought and governmental and economic writing.

c. Accounting for income tax expense requires measurement and identification with the appropriate time period and therefore involves accrual, deferral, and estimation concepts in the same manner as these concepts are applied in the measurement and time period identification of other expenses.

d. Matching is one of the basic processes of income determination; essentially it is a process of determining relationships between costs and expenses (including reductions of such items) and (1) specific revenues or (2) specific accounting periods. Costs and expenses of the current period consist of those costs and expenses which are identified with the revenues of the current period and those costs and expenses which are identified with the current period on some basis other than revenue. Costs identifiable with future revenues or otherwise identifiable with future time periods should be deferred to those future periods. When a cost cannot be related to future revenues or to future periods on some basis other than revenues, or it cannot reasonably be expected to be recovered from future revenues, it becomes, by necessity, a cost or an expense of the current period (or in some cases of a prior period.)

TIMING DIFFERENCES

Discussion

Nature of Timing Differences

15. Four types of transactions are identifiable which give rise to timing differences; that is, differences between the periods in which the transactions affect taxable income and the periods in which they enter into the determination of pretax accounting income.[7] Each timing difference originates in one period and reverses in one or more subsequent periods.

a. Revenues or gains are included in taxable income later than they are included in pretax accounting income. For example, gross profits on installment sales are recognized for accounting purposes in the year of sale but are reported for tax purposes in the year the installments are collected.

b. Expenses or losses are deducted in determining taxable income later than they are deducted in determining pretax accounting income. For example, estimated costs of guarantees and product warranty contracts are recognized in the current year for accounting purposes, but are reported in the year paid for tax purposes.

c. Revenues or gains are included in taxable income earlier than they are included in pretax accounting income. For example, rents collected in advance are reported for tax purposes in the year they are received but are deferred for accounting purposes until later periods when they are earned.

d. Expenses or losses are deducted in determining taxable income earlier than they are deducted in determining pretax accounting income. For example, depreciation is reported on an accelerated basis for tax purposes but is reported on a straight-line basis for accounting purposes.

Additional examples of each type of timing difference are presented in Appendix A to this Opinion.

16. The timing differences of revenue and expense items entering into the determination of pretax accounting income create problems in the measurement of income tax expense for a period since the income taxes payable for a period are not always determined by the same revenue and expense items used to determine pretax accounting income for the period. The amount of income taxes determined to be payable for a period does not, therefore, necessarily represent the appropriate income tax expense applicable to transactions recognized for financial accounting purposes in that period.

17. Interperiod tax allocation

---

[7] Accounting Research Study No. 9, *Interperiod Allocation of Corporate Income Taxes,* pages 2-3 and 8-10.

procedures have been developed to account for the tax effects of transactions which involve timing differences. Interperiod allocation of income taxes results in the recognition of tax effects in the same periods in which the related transactions are recognized in the determination of pretax accounting income.

Differing Viewpoints

18. Interpretations of the nature of timing differences are diverse, with the result that three basic methods of interperiod allocation of income taxes have developed and been adopted in practice. The three concepts and their applications are described and evaluated in Chapters 2, 3 and 4 of *Accounting Research Study No. 9*. A brief description of each method follows.

19. Interperiod tax allocation under the *deferred method* is a procedure whereby the tax effects of current timing differences are deferred currently and allocated to income tax expense of future periods when the timing differences reverse. The deferred method emphasizes the tax effects of timing differences on income of the period in which the differences originate. The deferred tax accounts are determined on the basis of the tax rates in effect at the time the timing differences originate and no adjustments are made for subsequent changes in tax rates or to reflect the imposition of new taxes. The tax effects of the transactions which reduce taxes currently payable are treated as deferred credits; the tax effects which increase taxes currently payable are treated as deferred charges. Amortization of these deferred taxes to income tax expense in future periods is based upon the nature of the transactions producing the tax effects and upon the manner in which these transactions enter into the determination of pretax accounting income in future periods.

20. Interperiod tax allocation under the *liability method* is a procedure whereby the income taxes expected to be paid on pretax accounting income are accrued currently. The taxes on components of pretax accounting income may be computed at different rates depending upon the period in which the components are expected to be includable in taxable income. The differences between income tax expense and income taxes payable in the periods in which the timing differences originate are either liabilities for taxes payable in the future or assets for prepaid taxes. The estimated amounts of future tax liabilities and prepaid taxes are computed at the tax rates expected to be in effect in the periods in which the timing differences reverse. Under the liability method the initial computations are considered to be tentative and are subject to future adjustment if tax rates change or new taxes are imposed.

21. Interperiod tax allocation under the *net of tax method* is a procedure whereby the tax effects (determined by either the deferred or liability methods) of timing differences are recognized in the valuation of assets and liabilities and the related revenues and expenses. These tax effects are applied to reduce specific assets or liabilities on the basis that tax deductibility or taxability are factors in their valuation.

22. In addition to the different methods of applying interperiod tax allocation, differences exist as to the extent to which interperiod tax allocation should be applied in practice.

23. Certain transactions result in differences between pretax accounting income and taxable income which are permanent[8] because under applicable tax laws and regulations the current differences will not be offset by corresponding differences in later periods. Permanent differences do not result in tax effects subject to interperiod tax allocation. Other transactions, however, result in differences between pretax accounting income and taxable income which reverse or turn around in later periods. These differences are classified broadly as timing differences. The tax effects of certain timing differences often are offset in the reversal or turnaround period by the tax effects of similar differences originating in that period. Some view these differences as essentially the same as permanent differences because, in effect, the periods of reversal are indefinitely postponed. Others believe that differences which originate in a period and differences which reverse in the same period are distinguishable phases of separate timing differences and should be considered separately.

24. In determining the accounting recognition of the tax effects of timing differences, the first question is whether there should be any tax allocation. One view holds that interperiod tax allocation is never appropriate. Under this concept, income tax expense of a period equals income taxes payable for that period. This concept is based on the presumption that income tax expense of a period should be measured by the amount determined to be payable for that period by applying the laws and regulations of the governmental unit, and that the amount requires no adjustment or allocation. This concept has not been used widely in practice and is not supported presently to any significant extent.

25. The predominant view holds that interperiod tax allocation is appropriate. However, two alternative concepts exist as to the extent to which it should be applied: partial allocation and comprehensive allocation.

Partial Allocation

26. Under partial allocation, a general presumption exists that income tax expense of a period for financial accounting purposes should be the tax payable to the levying government for the period. Holders of this view believe that when recurring differences between taxable income and pretax accounting income give rise to an indefinite postponement of an amount of tax payments or to continuing tax reductions, tax allocation is not required with respect to these differences. They believe that amounts

[8] See paragraph 33.

not reasonably expected to be payable to, or recoverable from, a government as taxes should not affect net income. They point out in particular that the application of tax allocation procedures to tax payments or recoveries which are postponed indefinitely involves contingencies which are at best remote and thus, in their opinion, may result in an overstatement or understatement of expenses with consequent effects on net income. An example of a recurring difference not requiring tax allocation under this view is the difference that arises when a company having a relatively stable or growing investment in depreciable assets uses straight-line depreciation in determining pretax accounting income but an accelerated method in determining taxable income. If tax allocation is applied to a company with large capital investments coupled with fixed asset growth (accentuated in periods of inflation) the resulting understatement of net income from using tax allocation is magnified.

27. Holders of the view expressed in paragraph 26 believe that the only exceptions to the general presumption stated therein should be those instances in which specific nonrecurring differences between the amount of taxable income and pretax accounting income would lead to a material misstatement of income taxes and net income. If such nonrecurring differences occur, income tax expense of a period for financial accounting purposes should be increased (or decreased) by income tax on differences between taxable income and pretax accounting income provided the amount of the increase (or decrease) can be reasonably expected to be paid as income tax (or recovered in a reduction of income taxes) within a relatively short period not exceeding, say, five years. An example would be an isolated installment sale of a productive facility in which the gross profit is reported for financial accounting purposes at the date of sale and for tax purposes when later collected. Thus, tax allocation is applicable only when the amounts are reasonably certain to affect the flow of resources used to pay taxes in the near future.

28. Holders of this view state that comprehensive tax allocation, as opposed to partial allocation described above, relies upon the so-called "revolving" account approach which seems to suggest that there is a similarity between deferred tax accruals and other balance sheet items, like accounts payable, where the individual items within an account turn over regularly although the account balance remains constant or grows. For these other items, the turnover reflects actual, specific transactions —goods are received, liabilities are recorded and payments are subsequently made. For deferred tax accruals on the other hand, no such transactions occur—the amounts are not owed to anyone; there is no specific date on which they become payable, if ever; and their amounts are at best vague estimates depending on future tax rates and many other uncertain factors. Those who favor partial allocation suggest that accounting deals with actual events, and that those who would depart from the fact of the tax payment should show that the modification will increase the usefulness of the reports to management, investors, or other users. To do this requires a demonstration that the current lower (or higher) tax payments will result in higher (or lower) cash outflows for taxes within a span of time that is of significant interest to readers of the financial statements.

Comprehensive Allocation

29. Under comprehensive allocation, income tax expense for a period includes the tax effects of all transactions entering into the determination of pretax accounting income for the period even though some transactions may affect the determination of taxes payable in a different period. This view recognizes that the amount of income tax payable for any given period does not necessarily measure the appropriate income tax expense related to transactions for that period. Under this view, income tax expense encompasses any accrual, deferral or estimation necessary to adjust the amount of income tax payable for the period to measure the tax effects of those transactions included in pretax accounting income for that period. Those supporting comprehensive allocation believe that the tax effects of any initial timing differences should be recognized and that these tax effects should be matched with or allocated to those periods in which the initial differences reverse. The fact that when the initial differences reverse other initial differences may offset any effect on the amount of taxable income does not, in their opinion, nullify the fact of the reversal. The offsetting relationships do not mean that the tax effects of these differences cannot be recognized and measured. Those supporting comprehensive allocation state that the makeup of the balances of certain deferred tax accounts "revolve" as the related differences reverse and are replaced by similar differences. These initial differences do reverse, and the tax effects thereof can be identified as readily as can those of any other timing differences. While new differences may have an offsetting effect, this does not alter the fact of the reversal (and accounting principles cannot be predicated on reliance that offsets will continue); if recognition is not given to initial differences there would be different tax consequences. Those supporting comprehensive allocation conclude that the fact that the tax effects of two transactions happen to go in opposite directions does not invalidate the necessity of recognizing separately the tax effects of these transactions as they occur.

30. Under comprehensive allocation, all tax effects are given recognition in the determination of income tax expense, and these tax effects are related to the periods in which the transactions enter into the determination of pretax accounting income. The tax effects are determined in the periods in which the differences between pretax accounting income and taxable income originate and are measured by the differential between income

taxes computed with and without inclusion of the differences between pretax accounting and taxable income which the transactions create. The tax effects so determined are allocated to the future periods in which the differences between pretax accounting income and taxable income reverse. Those supporting this view believe that comprehensive allocation is necessary in order to associate the tax effects with the related transactions. Only by the timely recognition of such tax effects is it possible to associate the tax effects of transactions with those transactions as they enter into the determination of net income. The need exists to recognize the tax effects of initial differences because only by doing so will the income tax expense in the period of initial differences include the tax effects of that period's transactions.

31. Those who support comprehensive allocation believe that the partial allocation concept in stressing cash outlays represents a departure from the accrual basis of accounting. Comprehensive allocation, in their view, results in a more thorough and consistent association in the matching of revenues and expenses, one of the basic processes of income determination.

32. These differences in viewpoint become most significant with respect to the tax effects of transactions of a recurring nature—for example, depreciation of machinery and equipment using the straight-line method for financial accounting purposes and an accelerated method for income tax purposes. Under partial allocation the tax effects of these timing differences would not be recognized under many circumstances; under comprehensive allocation the tax effects would be recognized beginning in the periods of the initial timing differences. Under partial allocation, the tax effects of these timing differences will not be recognized so long as it is assumed that similar timing differences would arise in the future creating tax effects at least equal to the reversing tax effects of the previous timing differences. Thus, under partial allocation, so long as the amount of deferred taxes is estimated to remain fixed or to increase, no need exists to recognize the tax effects of the initial differences because they probably will not "reverse" in the foreseeable future. Under comprehensive allocation all tax effects are recognized as they occur.

Permanent differences

33. Some differences between taxable income and pretax accounting income are generally referred to as permanent differences. Permanent differences arise from statutory provisions under which specified revenues are exempt from taxation and specified expenses are not allowable as deductions in determining taxable income. (Examples are interest received on municipal obligations and premiums paid on officers' life insurance.) Other permanent differences arise from items entering into the determination of taxable income which are not components of pretax accounting income in any period. (Examples are the special deduction for certain dividends received and the excess of statutory depletion over cost depletion.) Since permanent differences do not affect other periods, interperiod tax allocation is not appropriate to account for such differences.

Opinion

34. The Board has considered the various concepts of accounting for income taxes and has concluded that comprehensive interperiod tax allocation is an integral part of the determination of income tax expense. Therefore, income tax expense should include the tax effects of all revenue and expense items included in the determination of pretax accounting income. The tax effects of those transactions which enter into the determination of pretax accounting income either earlier or later than they become determinants of taxable income should be recognized in the periods in which the differences between pretax accounting income and taxable income arise and in the periods in which the differences reverse.

35. The Board has also concluded that the deferred method of tax allocation provides the most useful and practical approach to interperiod tax allocation and the presentation of income taxes in financial statements. Amortization of deferred taxes should be related to the transactions producing the tax effects and should be consistent with the manner in which these transactions affect the determination of pretax accounting income in future periods. Amortization is not related to the predicability of taxable income levels, to taxation rates of future periods, or to provisions of tax laws subsequently enacted.

36. The tax effect of a timing difference should be measured by the differential between income taxes computed with and without inclusion of the specific transaction creating the difference between taxable income and pretax accounting income. The resulting income tax expense for the period includes the tax effects of all transactions entering into the determination of results of operations for the period. The resulting deferred tax accounts reflect the tax effects which will be amortized in future periods. The measurement of income tax expense becomes thereby a consistent and integral part of the process of matching revenues and expenses in the determination of results of operations.

Special areas requiring further study

37. A number of other transactions have tax consequences somewhat similar to those discussed for timing differences. These transactions result in differences between taxable income and pretax accounting income in a period and, therefore, create a situation in which tax allocation procedures may be applicable in the determination of results of operations. These transactions are also characterized by the fact that the tax consequences of the initial differences between taxable income and pretax accounting income may not reverse until an indefinite future period or in some situations conceivably may never reverse. In addition, each of these transactions has certain unique as-

pects which create problems in the measurement and recognition of their tax consequences.

These special areas are:

a. Undistributed earnings of subsidiaries.
b. Intangible drilling costs on productive oil and gas wells.
c. "General reserves" of stock savings and loan associations.
d. Amounts designated as "policyholders' surplus" by stock life insurance companies.
e. Deposits in statutory reserve funds by United States steamship companies.

38. Paragraph 16 of ARB No. 51, *Consolidated Financial Statements,* states that:

> When separate income tax returns are filed, income taxes usually are incurred when earnings of subsidiaries are transferred to the parent. Where it is reasonable to assume that a part or all of the undistributed earnings of a subsidiary will be transferred to the parent in a taxable distribution, provision for related income taxes should be made on an estimated basis at the time the earnings are included in consolidated income, unless these taxes are immaterial in amount when effect is given, for example, to dividend-received deductions or foreign tax credits. There is no need to provide for income tax to the parent company in cases where the income has been, or there is evidence that it will be, permanently invested by the subsidiaries, or where the only likely distribution would be in the form of a tax-free liquidation.

The Board has decided to defer any modification of the above position until the accounting research study on accounting for intercorporate investments is completed and an Opinion is issued on that subject.

39. Intangible drilling costs incurred on productive oil and gas wells are commonly deducted in the determination of taxable income in the period in which the costs are incurred. Such costs are capitalized in most cases, however, for financial accounting purposes and are amortized over the productive periods of the related wells. A question exists as to whether the tax effects of the current deduction of these costs for tax purposes should be deferred and amortized over the productive periods of the wells to which the costs relate. The Board has decided to defer any conclusion on this question until the accounting research study on extractive industries is completed and an Opinion is issued on that subject.

40. The "general reserves" of stock savings and loan associations, amounts designated as "policyholders' surplus" by stock life insurance companies, and deposits in statutory reserve funds by United States steamship companies each have certain unique aspects concerning the events or conditions which may lead to reversal of the initial tax consequences. The Board has decided to defer any conclusion as to whether interperiod tax allocation should be required in these special areas, pending further study and consideration by the Board with a view to issuing Opinions on these areas at a later date.

OPERATING LOSSES

Discussion

41. An operating loss arises whenever, in the determination of taxable income, deductions exceed revenues. Under applicable tax laws and regulations operating losses of a period may be carried backward or forward for a definite period of time to be applied as a reduction in computing taxable income, if any, in those periods. Whenever an operating loss is so applied, pretax accounting income and taxable income will differ for the period to which the loss is applied.

42. If operating losses are carried backward to earlier periods under provisions of the tax law, the tax effects of the loss carry*backs* are included in the results of operations of the loss period, since realization is assured. If operating losses are carried *forward* under provisions of the tax law, the tax effects usually are not recognized in the accounts until the period of realization, since realizability of the benefits of the loss carry*forwards* generally is not assured in the loss period. The only exception to this practice occurs in unusual circumstances when realization is assured beyond any reasonable doubt in the loss period. Under an alternative view, however, the tax effects of loss carry*forwards* would be recognized in the loss period unless specific reasons exist to bring their realizability into question.

Opinion

43. The tax effects of any realizable loss carry*backs* should be recognized in the determination of net income (loss) of the loss periods. The tax loss gives rise to a refund (or claim for refund) of past taxes, which is both measurable and currently realizable; therefore the tax effect of the loss is properly recognizable in the determination of net income (loss) for the period.

44. The tax effects of loss carry*forwards* also relate to the determination of net income (loss) of the loss periods. With loss carry*forwards,* however, a significant question generally exists as to realization of the tax effects of the carry*forwards,* since realization is dependent upon the existence of future taxable income. Accordingly, the Board has concluded that recognition should not be given to the tax benefits of loss carry*forwards* until the tax benefits are actually realized, except in unusual circumstances when realization is *assured beyond any reasonable doubt* at the time the loss carry*forwards* arise. When the tax benefits of loss carry*forwards* are realized in full or in part in subsequent periods, such tax benefits should be reported in the results of operations of those periods as an extraordinary item.[9]

45. In those rare cases in which realization of the tax benefits of loss carry*forwards* is assured beyond any reasonable doubt, the potential benefits should be associated

---

[9] See APB Opinion No. 9, *Reporting the Results of Operations.*

with the periods of loss and should be recognized in the determination of results of operations for those periods. Realization is considered to be assured beyond any reasonable doubt when conditions such as those set forth in paragraph 46 are present. (Also see paragraph 47.) The amount of the asset (and the tax effect on results of operations) recognized in the loss period should be computed at the rates expected[10] to be in effect at the time of realization and should be disclosed in the financial statements. If the applicable tax rates change from those used to measure the tax effect at the time of recognition, the effect of the rate change should be accounted for in the period of the change as an adjustment of the asset account and of income tax expense.

46. Realization of the tax benefit of a loss carry*forward* would appear to be assured beyond any reasonable doubt when both of the following conditions exist: (a) the loss results from an identifiable, isolated, and nonrecurring cause and the company either has been continuously profitable over a long period or has suffered occasional losses which were more than offset by taxable income in subsequent years, and (b) future taxable income is virtually certain to be large enough to offset the loss carry*forward* and will occur soon enough to provide realization during the carry*forward* period.

47. Deferred tax credit accounts arising from timing differences may exist at the time loss carry*forwards* arise. In the usual case when the tax effect of a loss carry*forward* is not recognized in the loss period, adjustments of the existing deferred tax credit accounts may be necessary in that period or in subsequent periods. In this situation amounts in the deferred tax credit accounts should be eliminated to the extent of the lower of (a) the tax effect of the loss carry*forward*, or (b) the amortization of the deferred tax credits that would otherwise have occurred during the carry*forward* period. If the loss carry*forward* is realized in whole or in part in periods subsequent to the loss year, the amounts eliminated from the deferred tax credit accounts should be reinstated (at the then current tax rates) on a cumulative basis as those tax effects recur during the carry*forward* period. In the unusual situation in which the tax effect of a loss carry*forward* is recognized as an asset in the loss year,[11] the deferred tax credit accounts would be amortized in future periods as indicated in paragraph 35.

48. The tax effects of loss carry*forwards* of purchased subsidiaries (if not recognized by the subsidiary prior to purchase) should be recognized as assets at the date of purchase only if realization is assured beyond any reasonable doubt. Otherwise they should be recognized only when the tax benefits are actually realized and should be recorded as retroactive adjustments[12] of the purchase transactions and treated in accordance with the procedures described in paragraphs 7 and 8 of ARB No. 51, *Consolidated Financial Statements*. Retroactive adjustments[12] of results of operations for the periods subsequent to purchase may also be necessary if the balance sheet accounts affected have been subject to amortization in those periods.

49. Tax effects of loss carry*forwards* arising prior to a quasi-reorganization (including for this purpose the application of a deficit in retained earnings to contributed capital) should, if not previously recognized, be recorded as assets at the date of the quasi-reorganization only if realization is assured beyond any reasonable doubt. If not previously recognized and the benefits are actually realized at a later date, the tax effects should be added to contributed capital because the benefits are attributable to the loss periods prior to the quasi-reorganization.

INVESTMENT CREDIT

Discussion

50. The United States Internal Revenue Code provides for "investment credits" which, in general, are equivalent to specified percentages of the costs of certain depreciable assets acquired. The credits are subject to certain statutory limitations. The amounts available in any one year are used to reduce the amount of any income tax payable for that year. Although they do not result in timing differences or permanent differences as these terms are used in this Opinion, investment credits create another situation in which interperiod tax allocation may be applicable.

51. The Board previously has considered the problems in accounting for investment credits. Its views are found in APB Opinions Nos. 2 and 4, issued in December 1962 and March 1964. The Board stated in Opinion No. 2 that "there can be but one useful conclusion as to the nature of the investment credit and that it must be determined by the weight of pertinent factors." After identifying alternative views as to the nature of the investment credit, the Board concluded that the investment credit "should be reflected in net income over the productive life of acquired property and not in the year in which it is placed in service." This conclusion was based, in part at least, on the Board's analysis of the substance of the investment credit "as a reduction in or offset against a cost otherwise chargeable in a greater amount to future accounting periods."

52. In Opinion No. 4, the Board reaffirmed its preference for the conclusion on accounting for the investment credit as expressed in Opinion No. 2 (generally referred to as the *deferral method*), but stated additionally that "the alternative method of treating the credit as a reduction of Federal income taxes of the year in which the credit arises is also acceptable." This alternative method (generally

[10] The rates referred to here are those rates which, at the time the loss carry*forward* benefit is recognized for financial accounting purposes, have been enacted to apply to appropriate future periods.

[11] See paragraph 45.

[12] See APB Opinion No. 9, *Reporting the Results of Operations.*

referred to as the *flow-through method*) is supported in part at least by the view that the investment credit is in substance a selective reduction in taxes related to the taxable income of the year in which the credit arises.

53. Under amendments to the United States Internal Revenue Code enacted in 1966 and 1967, the investment credit was suspended, generally with regard to tangible property acquired between October 9, 1966, and March 9, 1967. Also, as of March 10, 1967, the maximum investment credit allowable in any year was increased from the limitation of 25% of the tax otherwise payable (which limitation had existed prior to October 9, 1966) to 50% of the tax otherwise payable.

54. The investment credit provisions of the Internal Revenue Code become applicable upon existence of two conditions:

a. the taxpayer acquires qualifying property in a period, which property will have a useful term of life, and be held or used, at least as long as certain time periods specified in the Code, and
b. the taxpayer has taxable income resulting in taxes payable against which the investment credit may be fully or partly offset. (Certain carry*back* and carry*forward* provisions exist.)

55. Under the *flow-through method* the tax effect of the investment credit is recognized in determining income tax expense in the period in which the credit is used in the determination of income taxes payable. The investment credit is considered to be a selective tax reduction in the year in which taxes otherwise payable are reduced by the credit. Thus, the investment credit is not viewed as a determinant of the cost of any asset or of the cost of using assets but is a reduction of income tax expense of the period when it is obtained.

56. Under the *deferral method* the tax effect of the investment credit is recognized in determining income tax expense in those periods in which the cost of the property acquired is amortized and thereby enters into the determination of results of operations of these periods. The investment credit is considered to be related both to the property acquired, which serves as the basis for the credit, and to income tax expense. The reduction in income tax expense which results from the investment credit is viewed as being related to the periods in which the cost of the property that gave rise to the credit is amortized by charges to income.

57. The advocates of the flow-through method as well as many of those who favor the deferral method generally agree that the investment credit represents an income tax benefit arising from a reduction of current taxes payable rather than a reduction in the cost of the asset or a temporary tax advantage that must be repaid at a future date. Thus, the difference in views concerns primarily the period in which the credit should be reflected in income. Advocates of the flow-through method believe, for several reasons, that the investment credit should be reflected in results of operations in the same period that the benefit is used to reduce income taxes payable:

a. The investment credit is both earned and realized by the occurence of two events: (1) making an investment in newly acquired facilities and (2) the existence of current taxable income arising for the most part from revenues earned currently through the use of facilities previously installed. Therefore, the investment credit currently realized does not depend on or relate to revenues earned during subsequent periods. Since there is no relationship between this element of income tax expense and future revenues there is no basis for deferral of the investment credit under the matching concept and amortization of it over subsequent accounting periods; instead it is earned in the same period in which it is realized.
b. The investment credit arises from transactions reflected in the same period for both financial accounting and tax purposes. Since the tax rules no longer require reduction in the cost basis of the asset there is no timing difference with respect to the investment credit. For this reason, the principles of interperiod allocation discussed elsewhere in this Opinion are not applicable.
c. Advocates of current recognition regard the opinion in paragraph 60, that the investment credit should be spread over the same asset life and by the same method as depreciation of the asset is determined for financial accounting purposes, as a contradiction of the Board's opinion that the investment credit is an element of income tax expense. This spreading requirement implies that the credit is a reduction in the cost of the asset not an adjustment of income tax expense.
d. Finally, by instituting or suspending the investment credit as desired to attempt the stimulation or curtailment of business activity, the Federal government uses the investment credit as an instrument of fiscal policy. The credit results in "cash in hand" in the period it enters into the determination of the final tax bill, available without restraint for any business purpose that management may elect. Accounting should not obscure the resulting impact on corporate earnings.

58. Advocates of the deferral method likewise offer several arguments to support reflecting the investment credit in financial accounting income in those periods and on the same basis as the cost of the acquired property giving rise to the investment credit enters

into the determination of net income:

a. The investment credit arises from the simultaneous existence of two sets of conditions: (1) the acquisition of property qualifying for the credit and (2) the incurrence of income taxes otherwise payable from operations or events unrelated to the investment credit. The incentive which the investment credit contains, as well as the genesis of the investment credit and its magnitude, are directly related to the acquisition of qualifying property. Further, the holding of the property during a stipulated time period is also required for the credit to be earned. The income taxes otherwise payable from operations or events unrelated to the investment credit merely govern the amount of the reduction in taxes payable. The investment credit is, therefore, primarily associated with the property which gives rise to the credit. Deferral of the investment credit and amortization of it over the periods of useful life of the property which gives rise to the credit result in associating the credit with those time periods with which the use of such property is associated. The matching thereby achieved is consistent with the objectives of income measurement.

b. Permitting the investment credit to flow through to net income in the period the benefit is used to reduce income taxes payable may result in increasing or decreasing reported net income solely by reason of the timing of acquisitions, rather than by the use, of property. The result is inconsistent with the accepted concept that income results from the use and not from the acquisition of assets. Allocation of the investment credit to those periods in which the property which gave rise to the credit is utilized associates the income effects of the credit with the use of the property, not its acquisition. This does not result in normalization of income as some have asserted, but results in the elimination of fluctuations in income arising from voluntary actions unrelated to the production of current income.

c. A conclusion that the investment credit should flow through to income in the same year the benefit is used to reduce taxes payable places this one element of income tax expense on the cash basis of accounting. Inasmuch as income taxes are an expense which involves accrual, deferral, and estimation concepts in much the same manner as these concepts apply to other expenses, all components of income tax expense should be subject to these accrual, deferral, and estimation concepts. The investment credit is no different from many other transactions that affect cash inflow or outflow in a period but enter into the determination of income in different periods.

d. Many transactions of a business have a tax effect which (1) is reflected in income tax expense, but (2) is dependent upon some other transaction insofar as allocation and timing of the effect on income is concerned. The close association of the investment credit with the property which gives rise to such credit carries no implication that the credit is an element of the cost of the property. Rather, it recognizes the investment credit for what it is—an element of income tax expense whose allocation and timing relate primarily to the item which gave rise to the credit, the property acquired.

e. To the extent that the Federal government has used the suspension and reinstatement of the investment credit as a matter of fiscal policy, there may be some effect on the decisions of corporate management with respect to the acquisition of qualifying property. Decisions as to property acquisitions, however, have no bearing on how periodic income should be determined and thus have no bearing on how the investment credit should be accounted for in financial statements. Property acquisitions have a prospective influence on earnings, whereas current earnings result from successful operations of the business of which the use of property, not its acquisition, is an integral part.

Opinion

59. The Board recognizes that each of the differing viewpoints expressed concerning the manner in which the investment credit should be accounted for possesses merit. However, it has concluded that the circumstances surrounding the investment credit do not justify alternative treatments. It also is aware that at present many, perhaps a majority of, companies account for the credit on a flow-through basis. However, the flow-through method, because it reflects the entire effect of the credit in the year in which it is obtained, can result in substantial fluctuations in net income unrelated to current revenue-producing activities. The recent statutory increase in the amount of allowable credit may result in a significant increase in the magnitude of these fluctuations.

60. The Board concludes that allowable investment credits should be applied in the determination of income tax expense in the same periods and on the same basis as the costs of the acquired properties giving rise to the investment credits enter into the determination of pretax accounting income through provisions for depreciation or amortization. This conclusion recognizes that the investment credit is essentially an element of

income tax expense, and that it additionally derives accounting significance from the *utilization* of the property to which it relates.

61. Unused investment credits, resulting from the absence of taxable income or from allowable limits provided in the Internal Revenue Code, may be carried backward or forward to other periods for tax purposes. The amount of refund arising from a carry*back* of an unused investment credit should be recognized as an asset and be added to the allowable investment credit for the current year, and accounted for as provided in paragraph 60.

62. Carry*forwards* of unused investment credits have characteristics similar to operating loss carry*forwards* (see paragraph 44). Recognition should not be given to the tax benefit of the carry*forwards* until the benefits are actually realized, except in unusual circumstances when realization is *assured beyond any reasonable doubt* at the time the loss carry*forwards* arise (also see paragraphs 45 and 46). In such circumstances the carry*forward* should be recognized as an asset and be added to the allowable investment credit for the current year, and accounted for as provided in paragraph 60. Unused investment credits not recognized because of doubts as to realization should be recognized only when realization occurs and should then be amortized to the remaining periods over which the costs of the properties which gave rise to the credits are being amortized.

TAX ALLOCATION WITHIN A PERIOD

Discussion

63. The need for tax allocation within a period arises because items included in the determination of taxable income may be presented for accounting purposes as (a) extraordinary items, (b) adjustments of prior periods or of the opening balance of retained earnings, or (c) as direct entries to other stockholders' equity accounts.

Opinion

64. The Board has concluded that tax allocation within a period should be applied in order to obtain an appropriate relationship between income tax expense and (a) income before extraordinary items, (b) extraordinary items, (c) adjustments of prior periods or of the opening balance of retained earnings, and (d) direct entries to other stockholders' equity accounts. The income tax expense attributable to income before extraordinary items is computed by determining the income tax expense related to all revenue and expense items entering into the determination of such income, without giving effect to the tax consequences of the items excluded from the determination of income before extraordinary items. The income tax expense attributable to other items is determined by the tax effects of transactions involving these items. If an operating loss exists before extraordinary items, the tax effect of such loss should be associated with the loss.

OTHER UNUSED DEDUCTIONS AND CREDITS

Opinion

65. The conclusions of this Opinion, including particularly the discussion in paragraphs 41-49 with respect to tax reductions resulting from operating losses, also apply to other unused deductions and credits for tax purposes that may be carried backward or forward in determining taxable income (for example, capital losses, contribution carryovers, and foreign tax credits).

FINANCIAL REPORTING

Discussion

Balance Sheet

66. Interperiod tax allocation procedures result in the recognition of several deferred tax accounts. Classification of these deferred tax accounts within the balance sheet has varied in practice, with the accounts reported, alternatively, as follows:

a. *Individual current and noncurrent amounts.* In this form of presentation all balance sheet accounts resulting from income tax allocation are classified into four separate categories — current assets, noncurrent assets, current liabilities and noncurrent liabilities.

b. *Net current and net noncurrent amounts.* In this form of presentation all balance sheet acounts resulting from income tax allocation are classified into two categories — net current amount (charge or credit) and net noncurrent amount (charge or credit).

c. *Single amount.* In this form of presentation all balance sheet accounts resulting from income tax allocation are combined in a single amount.

d. *Net of tax presentation.* Under this approach each balance sheet tax allocation account (or portions thereof) is reported as an offset to, or a valuation of, the asset or liability item that gave rise to the tax effect. Net of tax presentation is an extension of a valuation concept and treats the tax effects as valuation adjustments of the related assets and liabilities.

Income Statement

67. Interperiod tax allocation procedures result in income tax expense generally different from the amount of income tax payable for a period. Three alternative approaches have developed for reporting income tax expense:

a. *Combined amount.* In this presentation income tax expense for the period is reported as a single amount, after adjustment of the amount of income taxes payable for the period, for the tax effects of those transactions which had different effects on pretax accounting income and on taxable income. This form of presentation emphasizes that income tax expense for the period is related to those transactions entering into the determination of pretax accounting income.

b. *Combined amount plus disclosure (or two or more separate amounts).* In this presentation the amount of income tax reported on the tax return is considered significant additional information for users of financial statements. The amount of the tax payable (or the effect of tax allocation for the period) is, therefore, disclosed parenthetically or in a note to the financial statements. Alternatively, income tax expense may be disclosed in the income statement by presenting separate amounts—the tax return amount and the effects of tax allocation.

c. *"Net of tax" presentation.* Under the "net of tax" concept the tax effects recognized under interperiod tax allocation are considered to be valuation adjustments to the assets or liabilities giving rise to the adjustments. For example, depreciation deducted for tax purposes in excess of that recognized for financial accounting purposes is held to reduce the future utility of the related asset because of a loss of a portion of future tax deductibility. Thus, depreciation expense, rather than income tax expense, is adjusted for the tax effect of the difference between the depreciation amount used in the determination of taxable income and that used in the determination of pretax accounting income.

Opinion

Balance Sheet

68. Balance sheet accounts related to tax allocation are of three types:

a. Deferred charges and deferred credits relating to timing differences;

b. Refunds of past taxes or offsets to future taxes arising from the recognition of tax effects of carry*backs* and carry*forwards* of operating losses, investment credits and similar items;

c. Deferred credits relating to investment credits.

69. Deferred charges and deferred credits relating to timing differences should be classified in two categories—one for the net current amount and the other for the net noncurrent amount. This presentation is consistent with the customary distinction between current and noncurrent categories and also recognizes the close relationship among the various deferred tax accounts, all of which bear upon the determination of income tax expense. The current portions of such deferred charges and credits should be those amounts which relate to assets and liabilities classified as current. Thus, if installment receivables are a current asset, the deferred credits representing the tax effects of uncollected installment sales should be a current item; if an estimated provision for warranties is a current liability, the deferred charge representing the tax effect of such provision should be a current item. Any eliminations of amounts in deferred tax credit accounts in connection with the recognition of the tax effects of operating loss carry*forwards* should be made from the current or noncurrent accounts, as the case may be, depending upon the nature of the assets or liabilities which gave rise to the recognition of the initial tax effects.

70. Refunds of past taxes or offsets to future taxes arising from recognition of the tax effects of operating loss or investment credit carry*backs* or carry*forwards* should be classified either as current or noncurrent. The current portion should be determined by the extent to which realization is expected to occur during the current operating cycle as defined in Chapter 3A of ARB No. 43.

71. Tax allocation credit accounts relating to investment credits should generally be presented separately in the balance sheet in a manner parallel with the classification of the related assets. (Also see paragraph 69.)

72. Deferred taxes represent tax effects recognized in the determination of income tax expense in current and prior periods, and they should, therefore, be excluded from retained earnings or from any other account in the stockholders' equity section of the balance sheet.

Income Statement

73. In reporting the results of operations the components of income tax expense for the period should be disclosed, for example:

a. Taxes estimated to be payable
b. Tax effects of timing differences
c. Tax effects of investment credits
d. Tax effects of operating losses

These amounts should be allocated to (a) income before extraordinary items and (b) extraordinary items and may be presented as separate items in the income statement or, alternatively, as combined amounts with disclosure of the components parenthetically or in a note to the financial statements.

74. When the tax benefit of an operating loss carry*forward* is realized in full or in part in a subsequent period, and has not been previously recognized in the loss period, such tax benefit should be reported as an extraordinary item[13] in the results of operations of the period in which realized.

75. Tax effects attributable to adjustments of prior periods or of the opening balance of retained earnings, and direct entries to other stockholders' equity accounts should be presented as adjustments of such items with disclosure of the amounts of the tax effects.[13]

General

76. Certain other disclosures are necessary in addition to those set forth in paragraphs 68-75:

[13] See APB Opinion No. 9, *Reporting the Results of Operations.*

a. Amounts of any operating loss carry*forwards* not recognized in the loss period, or any unused investment credits not recognized, together with expiration dates (indicating separately amounts which, upon recognition, would be credited to deferred tax accounts);

b. Significant amounts of any other unused deductions or credits, together with expiration dates; and

c. Reasons for significant variations in the customary relationships between income tax expense and pretax accounting income if they are not otherwise apparent from the financial statements or from the nature of the entity's business.

The Board recommends that the nature of significant differences between pretax accounting income and taxable income be disclosed.

77. The "net of tax" form of presentation should not be used for financial reporting. The tax effects of transactions entering into the determination of pretax accounting income for one period but affecting the determination of taxable income in a different period should be reported in the income statement as elements of income tax expense and in the balance sheet as tax allocation accounts (deferred taxes) and not as elements of valuation of assets or liabilities.

EFFECTIVE DATE

78. This Opinion shall be effective for all fiscal periods that begin after December 31, 1967. However, the Board encourages earlier application of the provisions of this Opinion.

79. Accordingly, the tax allocation procedures set forth in this Opinion should be applied to transactions whose initial tax effect occurs after the effective date. Ballance sheet accounts which arose from interperiod tax allocation and accounts stated on a net of tax basis, prior to the effective date of this Opinion, should be presented in the manner recommended by this Opinion.

80. The Board recognizes that companies may apply this Opinion retroactively to periods prior to the effective date in order to obtain comparability in financial presentations for the current and future periods. If the procedures are applied retroactively, they should be applied to all material items of those periods insofar as the recognition of prior period tax effects of timing differences, investment credits, operating losses, and other deductions or credits is concerned. However, because of its special nature, the investment credit sections may be applied on a retroactive basis even though other sections are not applied retroactively. Any adjustments made to give retroactive effect to the conclusions stated in this Opinion should be considered adjustments of prior periods and treated accordingly.

NOTES

Opinions present the considered opinion of at least two-thirds of the members of the Accounting Principles Board, reached on a formal vote after examination of the subject matter.

Except as indicated in the succeeding paragraph, the authority of the Opinions rests upon their general acceptability. While it is recognized that general rules may be subject to exception, the burden of justifying departures from Board Opinions must be assumed by those who adopt other practices.

Action of Council of the Institute (Special Bulletin, *Disclosure of Departures From Opinions of Accounting Principles Board,* October 1964) provides that:

a. "Generally accepted accounting principles" are those principles which have substantial authoritative support.

b. Opinions of the Accounting Principles Board constitute "substantial authoritative support".

c. "Substantial authoritative support" can exist for accounting principles that differ from Opinions of the Accounting Principles Board.

The Council action also requires that departures from Board Opinions be disclosed in footnotes to the financial statements or in independent auditors' reports when the effect of the departure on the financial statements is material.

Unless otherwise stated, Opinions of the Board are not intended to be retroactive. They are not intended to be applicable to immaterial items.

APPENDIX A

The following examples of timing differences indicate the kinds of transactions and events for which interperiod tax allocation is appropriate. These examples were adapted from Accounting Research Study No. 9, *Interperiod Allocation of Corporate Income Taxes,* by Homer A. Black, pages 8-10.

(A) *Revenues or gains are taxed after accrued for accounting purposes:*

Profits on installment sales are recorded for accounting purposes at the date of the sale and are reported for tax purposes when collections on the sales are made in later periods.

Revenues on long-term contracts are recorded for accounting purposes on the percentage-of-completion basis and are reported for tax purposes on the completed-contract basis.

Revenue from leasing activities is recorded for accounting purposes by a lessor based on the financing method of accounting, and such revenue exceeds rent less depreciation reported for tax purposes in the early years of a lease.

(B) *Expenses or losses are deducted for tax purposes after accrued for accounting purposes:*

Estimated costs of guarantees and product warranty contracts are recorded for accounting purposes in the period of sale and are deducted for tax purposes when payments are made in later periods.

Expenses for deferred compensation, profit sharing, bonuses, and severance pay are recorded for accounting purposes when accrued for the applicable period and are deducted for tax purposes when payments are made in later periods.

Expenses for pension costs are recorded for accounting purposes when accrued for the applicable period and are deducted for tax purposes in later periods when contributions are made to the pension fund.

Current expenses for self-insurance are recorded for accounting purposes based on consistent computations for the plan and are deducted for tax purposes as losses are incurred in later periods.

Estimated losses on purchase commitments are recorded for accounting purposes when reasonably anticipated and are deducted for tax purposes when later realized.

Estimated losses on disposal of facilities and/or from discontinuance or relocation of operations are recorded for accounting purposes when anticipated and determinable and are deducted for tax purposes when losses or costs are later incurred.

Estimated expenses of settling pending lawsuits and claims are recorded for accounting purposes when reasonably ascertainable and are deducted for tax purposes when paid in later periods.

Provisions for major repairs and maintenance are accrued for accounting purposes on a systematic basis and are deducted for tax purposes when payments are made in later periods.

Depreciation recorded for accounting purposes exceeds that deducted for tax purposes in early years because of:

accelerated method of computation for accounting purposes

shorter lives for accounting purposes

Organization costs are written off for accounting purposes as incurred and are amortized for tax purposes as permitted by applicable laws.

(C) *Revenues or gains are taxed before accrued for accounting purposes:*

Rent and royalties are reported for tax purposes when collected and are deferred for accounting purposes to later periods in which they are earned.

Fees, dues, and service contracts are reported for tax purposes when collected and are deferred for accounting purposes to later periods when they are earned.

Profits on intercompany transactions are reported for tax purposes when reported in separate returns and are deferred for reporting purposes in consolidated financial statements until the assets involved in the intercompany transactions are transferred outside the intercompany group.

Gains on sales of property leased back are reported for tax purposes in the period of sale and are deferred for accounting purposes to be amortized during the term of lease.

Proceeds of sales of oil payments or ore payments are reported for tax purposes at the date of sale and deferred for accounting purposes to be recognized as revenue as the oil or ore is produced.

(D) *Expenses or losses are deducted for tax purposes before accrued for accounting purposes:*

Depreciation deducted for tax purposes exceeds that recorded for accounting purposes in early years because of:

accelerated method of computation for tax purposes

shorter guideline lives for tax purposes

amortization of emergency facilities under certificates of necessity.

Unamortized discount, issue cost and redemption premium on bonds refunded are deducted for tax purposes in the year of redemption or refunding and are deferred to be amortized for accounting purposes.

Research and development costs are deducted for tax purposes when incurred and are deferred to be amortized for accounting purpurposes.

Interest and taxes during construction are deducted for tax purposes when incurred and are included for accounting purposes in the cost of assets to be amortized in future periods.

Preoperating expenses are deducted for tax purposes when incurred and are deferred to be amortized to future periods for accounting purposes.